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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1013

TEXAS EASTERN TRANSMISSION CORPORATION,
A Delaware Corporation authorized to do business in New Jersey,

Appellant,

vs.

WILLIAM KINGSLEY, Director of the Division of Taxation, Department of the Treasury, State of New Jersey,

Appellee.

On Appeal from the Supreme Court of New Jersey

MOTION TO DISMISS AND BRIEF IN SUPPORT THEREOF

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Motion to Dismiss

Pursuant to Rule 16(1)(b) of this Court, the Attorney General of the State of New Jersey, on behalf of the Appellee, hereby moves to dismiss this appeal on the grounds that it does not present a substantial federal question.

BRIEF IN SUPPORT OF MOTION

Question Presented

Does the Commerce Clause or the Due Process Clause of the Constitution of the United States preclude New Jersey from reflecting the receipts derived from sales occurring in New Jersey of natural gas by appellant, an interstate natural gas carrier, to another interstate natural gas carrier in the numerator of the receipts portion of the three factor business allocation factor in order to properly apportion to New Jersey appellant's tax bases under the New Jersey Corporation Business Tax Act, N.J.S.A. 54:10A-1 *et seq.*?

Statement of the Case

The issue presented in this case relates to the propriety of Appellee, Director of the New Jersey Division of Taxation ("Director"), utilizing in-state sales made by the Appellant, Texas Eastern Transmission Corporation ("Texas Eastern"), for purposes of determinnig the apportionment factor under the New Jersey Corporation Business Tax Act, N.J.S.A. 54:10A-1 *et seq.* ("the act"). The act is a franchise tax exacted by the State of New Jersey from every domestic and foreign corporation,

> ". . . for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State. . . ." N.J.S.A. 54:10A-2.

The tax is computed by adding together prescribed percentages of a net worth tax base, which constitutes essentially the stockholders' book equity, and a net income tax base, which prima facie reflects taxable income reported to the federal government with certain exceptions not here pertinent. N.J.S.A. 54:10A-4(d), 4(k) and 5. In order to provide a fair method for allocating a taxpayer's net income and net worth, the act employs a three-part formula, denominated as the business allocation factor, which attempts to relate the taxpayer's New Jersey business to that exercised by the total franchise. This formula, which is generically known as the "Massachusetts formula", is a composite of the average value of real and tangible personal property, receipts and payroll in New Jersey as against the totals thereof everywhere. N.J.S.A. 54:10A-6.

Texas Eastern is in the business of transporting and selling natural gas by pipeline from producing fields located principally in Texas and Louisiana to markets in the Midwest and Northwest United States. The natural gas transported by Texas Eastern was actually owned by it and was acquired from the company's own producing fields as well as through purchases made from independent producers.

For the year 1967, which is the only year involved in this case, Texas Eastern sold a total of 204,647,920 MCF of natural gas in New Jersey. Of this amount, 88,512,234 MCF were sold and transferred to three New Jersey public utilities, Public Service Electric and Gas Company, New Jersey Natural Gas Company and Elizabethtown Gas Company, while 116,135,686 of MCF were sold and transferred to Algonquin Gas Transmission Company ("Algonquin"). Of the total amount of gas sold to Algonquin in 1967, 114,828,686 MCF were destined for delivery by Algonquin in other states and 1,309,000 MCF were sold by

Algonquin to the New Jersey Natural Gas Company for resale to New Jersey consumers.

In consideration for the sale to Algonquin of the 114,-835,686 MCF Texas Eastern received $49,042,131.00. These receipts of Texas Eastern were not allocated to any other state for purposes of computing that state's franchise tax formulation. Algonquin resold the 14,835,686 MCF it purchased from Texas Eastern for the amount of $65,120,-457.81, thus making a gross profit on this transaction of $16,078,326.81.

The sales and transfers of natural gas by Texas Eastern to the three New Jersey utilities and to Algonquin constituted what are denominated in the Natural Gas Act (15 U.S.C. § 717) as "sales for resale". Each such sale involved the physical transfer of the natural gas from the pipelines of Texas Eastern to the connecting pipelines of either the New Jersey utilities or Algonquin. The only mechanical difference between the transfer of the natural gas on the one hand to Algonquin and on the other hand to the New Jersey utilities was that the pressure of the flow was reduced in the latter transfer in order to permit the distribution of the gas to the New Jersey facilities.

During 1967, Texas Eastern had extensive facilities in New Jersey for the purpose of maintaining and operating its pipeline system. The company employed 29 people in this State commanding a total payroll of $214,376.28. Its facilities consisted of 209.6 miles of underground pipeline, a maintenance office in Linden and various measuring and regulating equipment necessary and appurtenant to the operation of its pipeline system. The value of this property was in excess of $39 million. The measuring equipment, which was located at the points of transfer, automatically measured and recorded, by means of a calibrated orifice plate and other instruments, the volume of

natural gas flowing from Texas Eastern's pipelines to those of its customers, including Algonquin.

This matter was submitted to the New Jersey Division of Tax Appeals on a stipulation of facts, following which a decision was rendered on June 5, 1975 opining that the statutory allocation formula as applied to Texas Eastern was constitutional in all respects (A. 14a to A. 43a). The Appellate Division affirmed the judgment of the trial court in an opinion dated June 23, 1976 (A. 45a). On October 25, 1976, the Supreme Court of New Jersey denied Texas Eastern's petition for certification (A. 46a) and dismissed its appeal (A. 47a).

ARGUMENT

The appeal should be dismissed because the appellant has not presented a substantial federal question.

A. The inclusion of the receipts from sales to a vendee within New Jersey in the numerator of the receipts allocation factor was proper under the commerce clause of the United States Constitution since such inclusion properly reflected appellant's New Jersey activities and did not cumulatively burden interstate commerce.

A taxpayer who asserts that a tax violates the commerce clause of the United States Constitution has the burden of showing the invalidity of the tax. *City of Chicago* v. *Willett Co.*, 344 U.S. 574, 578 (1953). This Court, in a long line of cases, has definitively stated that immunity from state taxation is not bestowed upon corporate activities merely because those activities are denominated as interstate commerce. *Evco* v. *Jones*, 409 U.S. 91,

(1972); *General Motors Corp.* v. *Washington,* 377 U.S. 436 (1964). This principle was reemphasized in the most recent decisions of the Court involving the constitutionality of state excise tax laws. *Standard Pressed Steel Co.* v. *Washington,* 419 U.S. 560 (1975); *United Airlines, Inc.* v. *Mahin,* 410 U.S. 623 (1973).

This Court has furthermore established that interstate natural gas carriers such as Texas Eastern are neither privileged nor immune corporate entities with respect to state taxing laws. In *Colonial Pipeline* v. *Traigle,* 421 U.S. 100 (1975), the Court sustained the imposition of a Louisiana franchise tax upon a pipeline carrier of liquified petroleum products that conducted only interstate commerce within the taxing state. Similar results were reached in *Memphis Natural Gas Co.* v. *Stone,* 335 U.S. 80 (1948), and *Memphis Natural Gas Co.* v. *Beeler,* 315 U.S. 649 (1942).

The most significant decision involving apportionment of state franchise taxes was rendered in the consolidated cases of *Northwestern States Portland Cement Co.* v. *Minnesota and Williams* v. *Stockham Valves & Fittings, Inc.,* 358 U.S. 450 (1959), which sustained the constitutionality of state net income taxes applied to corporations engaged solely in activities within the taxing states which were in furtherance of interstate commerce:

> ". . . the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by *formulas utilizing in-state aspects of interstate affairs.*" (emphasis added). 358 U.S. at 460.

It is important to note that in the *Northwestern* case, the Minnesota taxing statute utilized essentially the same

three-part formula found in the New Jersey Corporation Business Tax Act, which formula has been explicitly recognized by this Court as an appropriate means for apportioning a multi-state franchise. *Butler Bros.* v. *McColgan,* 315 U.S. 501 (1942).

The *Northwestern* case was reflective of a long line of cases upholding the utilization of in-state receipts from interstate sales in the numerator of allocation formulas for purposes of computing state franchise taxes. *International Harvestor Co.* v. *Evatt,* 329 U.S. 416 (1947); *Western Cartridge Co.* v. *Emmerson,* 281 U.S. 511 (1930); *Hump Hairpin Manufacturing Co.* v. *Emmerson,* 258 U.S. 290 (1922); *West Publishing Co.* v. *McColgan,* 27 Cal. 2d 705, 166 P. 2d 861 (Cal. Sup. Ct. 1946), aff'd 328 U.S. 823 (1945); *Maxwell* v. *Kent-Coffey Mfg. Co.,* 204 N.C. 365, 168 S.E. 397, 90 A.L.R. 476 (N.C. Sup. Ct. 1933), aff'd 291 U.S. 642 (1933). The utilization of such in-state receipts in an allocation factor establishes an appropriate means for insuring multi-state corporations, including interstate natural gas carriers, with a proper apportionment of their franchises to the taxing state. *Wisconsin & Michigan Steamship Company* v. *Michigan Corporation & Securities Commission,* 371 Mich. 61, 123 N.W. 2d 258, 262 (Mich. Sup. Ct. 1963), cert. den. 376 U.S. 912 (1964); *Duluth South S. & A. R. Co.* v. *Michigan Corporation & Securities Commission,* 353 Mich. 636, 92 N.W. 2d 22, 37-38 (Mich. Sup. Ct. 1958), *cert.* den. 359 U.S. 310 (1958).

The utilization of the receipts derived from the sales of Algonquin within New Jersey in the numerator of the receipts allocation factor conforms to *Northwestern* and the other leading cases dealing with apportionment of multi-state franchises for franchise tax purposes. Since the receipts in question reflect the in-state transfer and

sale of natural gas by Texas Eastern in New Jersey, the employment of these receipts in the numerator of the receipts allocation factor establishes an appropriate method for apportioning to New Jersey Texas Eastern's tax bases. Texas Eastern's involvement in the transaction ceased in New Jersey when it relinquished its ownership rights over the gas. It is of no relevance to this case that Algonquin, the vendee, intended to transport a portion of the natural gas purchased within New Jersey to out-of-state customers, particularly since the interpretation of a tax statute should not be related to the intention of a vendee subsequent to transacting an in-state sale. *International Harvestor Co.* v. *Dept. of Treasury of State of Indiana,* 322 U.S. 340, 346 (1944).

The reliance by Texas Eastern upon *Norfolk & Western Ry. Co.* v. *Missouri State Tax Comm'n,* 390 U.S. 317 (1968), *Hans Rees' Sons* v. *North Carolina,* 283 U.S. 123 (1931), and *Wallace* v. *Hines,* 253 U.S. 66 (1920), is clearly misplaced. These cases do not relate to the propriety for utilizing in-state receipts in franchise tax allocation formulas and merely establish that one-factor apportionment formulas are vulnerable to an attack of unconstitutionality. In both *Norfolk & Western Ry. Co.* and *Hans Rees' Sons* the taxpayers were able to establish by alternative methods that the tax base being apportioned by the alloction factor to the tax state was much greater than the actual tax base being employed within the taxing state. Texas Eastern has failed to establish that the application of the statutory business allocation factor was not reasonably reflective of the appropriate portions of its tax bases employed within this State.

It is furthermore evident that the employment of the receipts derived from the Algonquin sales in the numerator of the receipts factor did not create a multiple or cumulative tax burden upon Texas Eastern. As aptly stated in *Northwestern, supra,* 358 U.S. at 462,

> "There is nothing to show that multiple taxation is present. We cannot deal in abstractions. In this type of case the taxpayers must show that the formula places a burden upon interstate commerce in a constitutional sense. This they have failed to do.

In order to demonstrate that the New Jersey formula burdened interstate commerce, Texas Eastern was required to show that another state was utilizing the receipts in question to place an additional franchise tax burden upon its activities. *General Motors Corp.* v. *State of Washington, supra.* Clearly the fact that no other state allocated in its apportionment formula the receipts derived from the Algonquin sales for purposes of computing that state's allocation formula insulated Texas Eastern from any multiple tax burden.

Texas Eastern has failed to demonstrate that the statutory allocation provision as applied to its tax bases for the 1967 tax year resulted in an apportionment which exceeded the constitutional bounds of the commerce clause. This Court has conclusively established in its prior decisions the propriety on the part of a taxing state to utilize in-state receipts resulting from interstate sales in computing franchise tax allocation factors in the context of the commerce clause as a proper means for reflecting in-state activity. The present case, as it relates to the commerce clause, does not involve unsettled questions requiring the further review of this Court.

B. Since the sale and transfer of the natural gas occurred within this State, New Jersey had the proper nexus consistent with the due process clause of the Fourteenth Amendment to the United States Constitution to allocate the receipts from these sales to this State in the receipts factor of the allocation formula.

The due process clause of the United States Constitution requires that excise taxes must be,

> ". . . levied only on that portion of the taxpayer's net income which arises from its activities within the taxing State. These activities form a sufficient 'nexus between such a tax and transactions within a state for which the tax is an exaction.' *State of Wisconsin* v. *J. C. Penney Co., supra,* 311 U.S. at page 250." *Northwestern Portland Cement* v. *Minnesota, supra,* 358 U.S. at 464.

Clearly in the present case the nexus or connection requirement permitting the utilization of the Algonquin receipts in the numerator of the receipts factor was satisfied since the actual transfer and sale occurred within New Jersey.

In *International Harvester Co.* v. *Dept. of Treasury of State of Indiana, supra,* 322 U.S. at 345, the Court noted that:

> "The fact that the sales . . . are made by an out-of-state seller and that the contracts were made outside the State is not controlling. Here . . . delivery of the goods in Indiana is an adequate taxable event."

The issue in *International Harvestor* concerned whether a sales tax could properly be levied upon certain transactions. One of the transactions in question involved sales

in Indiana to an out-of-state buyer who came to Indiana merely for the purpose of taking delivery. Subsequent to delivery, the buyer immediately transported the goods to another state. In upholding the validity of imposing the sales tax upon such a transaction, the court stated that,

> ". . . it is immaterial to the present issue that the goods are to be transported out of Indiana immediately on delivery. . . ." 322 U.S. at 346.

Since the Court in *International Harvestor* permitted the imposition of a sales tax upon the sale of an item destined for out-of-state transportation, clearly New Jersey was entitled to appropriate the receipts in question for allocation purposes. The fact that the natural gas sold to Algonquin was destined to be transported out-of-state after the transfer took place did not immunize such receipts from either being directly taxed or being considered New Jersey receipts under the tax allocation formula.

The essential transaction in this case, namely the actual physical transfer of the gas, took place *only* in New Jersey. The pipelines of Texas Eastern and Algonquin connected in New Jersey and, therefore, New Jersey was the location of the in-state shipment and transfer of the natural gas from Texas Eastern to Algonquin. Since no other state had a more proximate relationship with those receipts, it is illogical for appellant to contend that New Jersey was only remotely and incidentally related thereto. New Jersey, by being the state in which the transfers of natural gas occurred, had the proper nexus to consider the receipts therefrom as constituting in-state activities for apportionment purposes. Under well-established constitutional principles, therefore, the utilization by New Jersey of the receipts in question in

the numerator of the sales portion of the business allocation factor did not contravene the due process clause since no extraterritorial activities were being allocated to New Jersey.

CONCLUSION

It is respectfully submitted, therefore, that the appellant has not presented any substantial federal questions which warrant the further attention of this Court and that this appeal should be dismissed.

Respectfully submitted,

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